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Dear Nigel

**Ofgem Impact Assessment on Identification and Apportionment of Costs of Unidentified Gas (Mods 0194/0194a/0228/0228a and 0229)**

Shell Gas Direct (SGD) Ltd, the holder of both gas supplier (non-domestic) and shipper licences, offers the following comments in response to Ofgem's consultation document. This response is not confidential and so may be placed on your website.

**Background**

SGD proposed UNC Modification Proposal 0229 in response to the other proposals. We were concerned that these proposals lacked a robust methodology that would give comfort to shippers that the 'numbers' were not being skewed in favour of one market sector over another, with negative impacts on competition. The only way to resolve these concerns, it would appear, was via the appointment of an independent 3<sup>rd</sup> party.

In an attempt to detail the flaws in the other proposals, the I&C-only Shippers and Suppliers group (ICOSS), of which SGD is a member, commissioned a study from TPA Solutions. This report has been forwarded to Ofgem and, we believe, implicitly supports Ofgem's 'minded to accept' view re 0229 as it confirms our views of the other proposals.

***Question 1: Do you agree with Ofgem's assessment that the likely impact of the Modification Proposals on charges made to consumers?***

In broad terms, any proposal that seeks to shift charges from one part of the market to another will result in a change to customer charges in the market sectors concerned. The scale of the actual charges identified by Ofgem seems justified on the basis of the evidence and analysis provided in the IA.

Another and related point – and one that SGD made when proposing 0229 – is how any reallocation of costs could be proved to have benefited the SSP market? In other words, absent of 0229, how would it be possible to determine that any reduction in the SSP proportion of costs was not used by parties with a combined domestic/I&C portfolio to subsidise their LSP portfolio – to the cost of competition in the I&C sector – rather than reduce domestic charges?

***Question 2: Do you consider that the proposed governance arrangements under UNC229 offer adequate protection to the interests of consumers in their present form?***

Absent of broader questions that Ofgem may be asking in its Governance Review, the UNCC offers the most adequate and comprehensive safeguard when considering the interests of consumers. The multiplicity of shippers with different portfolio compositions, each arguing for their customer base, should ensure that the interests of all consumers are considered.

To the extent that changes to the process outlined in 0229 subsequently need to be revised, updated or amended, it is not quite clear why faith cannot be maintained in the UNC principle itself (regardless of its exact processes following Ofgem's Governance Review) as the vehicle for managing change in a transparent and consultative manner? In other words, why should 0229 be different to any other modification proposal?

***Question 3: Do you anticipate any further impact upon consumers in addition to those considered in this chapter?***

As identified previously, Ofgem should not underestimate the likely impact on competition in the domestic and I&C retail markets if a proposal other than 0229 is implemented. SGD's concern revolves around the issue of cross-subsidy alluded to in our answer to Q1 and the impact this could have on increasing market concentration.

**CHAPTER: Four**

***Question 1: Do you agree with our assessment that any of these Modification Proposals will have an effect upon incentives for shippers to reduce the quantity of Unidentified Gas offtaken at LDZs?***

In short, SGD does not think that any of the proposals will have a direct impact in this area. It could be argued, however, that the work of the AUGÉ under 0229 may give a more comprehensive understanding of where and when volumes of unidentified gas might presumably occur – it is this work that might then feed into considering how best to incentivise the reduction in unidentified gas volumes.

***Question 2: Do you agree with our assessment of the likely distributional impact of the Modification Proposals?***

SGD has no material comments to make in addition to Ofgem's view of the distributional impact of the Modification Proposals.

***Question 3: Do you believe that the potential benefits of the Modification Proposals justify the additional costs which may be imposed on customers?***

It is difficult to conclude that the costs of any of the proposals would outweigh the 'benefits'. However, Mods 0194, 0228 and 0228a are nothing more than reallocating costs between different market segments and in a way that does little to offer any comfort that:

- a) that there is a greater and increasing understanding of the origins of volumes of unidentified gas; and
- b) competition between shippers and suppliers will not be damaged (see our answers to Q1 and Q3).

Rather, it is 0229 that will ultimately benefit consumers in that it seeks:

- a) an impartial investigation into not just the correct allocation, along with providing a better understanding of the potential causes of unidentified gas volumes; and
- b) to pass any reallocation of costs in such a way that they are passed on to consumers in a non-distortionary manner.

Moreover, in relation to on-going costs, TPA's study should provide a comprehensive basis for the work of a future AUGE. Given that TPA's study has already been funded by ICOS shippers, any subsequent costs of 0229 should logically have been minimised.

***Question 4: Do you agree that applying a variable RbD charge upon LSP shippers would potentially entail a negative impact upon competition? Do you feel that this potential impact justifies the imposition of a fixed rather than variable charge on LSP shippers?***

This question, in many ways, goes to the heart of the debate contained in the various modification proposals. A variable RbD charge on LSP shippers would suggest that the following can be substantiated:

- a) that unidentified gas volumes vary with throughput; and
- b) the level of costs to be attributed between SSP and LSP points on a 'fixed' or 'predictable' basis.

The work of TPA would suggest that both assumptions are incorrect. Indeed, it is our view that that 0194 and 0228 are simple and short-term attempts at reallocating costs with no reference to methodology or the long-term impact on competition.

SGD is therefore against the introduction of a variable RbD charge. In taking this view, it is at least partly backed-up by Ofgem's decision in the last Price Control settlement to opt for a volume-based Shrinkage allowance on the basis that this provided for a more accurate reflection of losses.

***Question 5: Should any third party authority created under the terms of UNC229 be tasked to review incentives for investigating theft upon individual shippers?***

When proposing 0229, SGD did not have this type of role in mind for the AUGE. Rather, the AUGE is there to devise the most transparent, objective and impartial way of calculating and allocating volumes and costs of unidentified gas between different market segments.

However, given the nature and work of the AUGE, it would not be unreasonable to conclude that its findings could not be used in other industry fora looking at the issue of incentives per se.

## **CHAPTER: Five**

***Question 1: Do you agree with Ofgem's assessment that any impact on sustainable development as a result of these Modification Proposals is likely to be marginal?***

SGD agrees with Ofgem's assessment that these modifications will have a marginal impact on sustainable development.

**Question 2: Do you agree with Ofgem's assessment of the relative impact on sustainable development of each of the Modification Proposals?**

See our answer to Q1.

**Question 3: Do you consider that there are any further impacts on sustainable development that are likely to result from the Modification Proposals?**

We do not anticipate any further impacts.

#### **CHAPTER: Six**

**Question 1: Do you anticipate any impact on health and safety as a result of these Modification Proposals? If so, what?**

SGD does not anticipate an impact in this area.

#### **CHAPTER: Seven**

**Question 1: Do you agree that implementation of UNC229 would leave parties with adequate recourse to query decisions made by the AUGE?**

The process outlined in 0229 offers sufficient safeguards to shippers in this respect. Indeed, SGD was conscious of the concerns of a number of parties that they would have no ability to challenge the AUGE. Moreover, if concerns in this regard became material, shippers would be free to raise modification proposals seeking alternatives to 0229.

However, under 0229 once a methodology has been agreed, it is our view that any challenge should be on the correct application of that methodology – not the methodology itself.

**Question 2: If not, how should any additional governance be implemented?**

No additional work is required.

**Question 3: Are there any additional risks which may be placed upon industry parties by implementation of the Modification Proposals within scope of this Impact Assessment which we have not identified in this document?**

SGD has nothing to add to our previous answers (see sections 3 and 4).

**Question 4: How could the Governance Arrangements for appointment of an AUGE be structured to minimise impact upon shipper parties? Should GTs be indemnified from any risks from holding this contract, and if so how might this be implemented in practice?**

SGD does not believe that the Governance Arrangements in 0229 place an undue impact on shippers. To that extent, we have nothing to say in response to the first part of the question.

With regards to the issue of GTs and their risk under 0229, SGD is as unclear now as it was more than a year ago as to the detail and materiality of their concerns. 0229 provides for any claim by the AUGE to be limited to payment of its fees and so this

would be the only 'liability' for GTs. However, given that shippers will meet all costs associated with the work of the AUGÉ, it is difficult to see why this would be a concern of any note.

To the extent that GTs still have concerns, it is regrettable that they have been unable to articulate them – and they were given many opportunities to do so - in a timely manner such that the development of 0229 could incorporate their views. Indeed, GTs were offered the chance of writing their own 'indemnification' wording but decided not to do so.

However, in response to the second part of the question, the examples of 3<sup>rd</sup> parties such as the RbD auditor and the Meter Error Expert would be useful to consider as potential models.

## **CHAPTER: Eight**

***Question 1: Do you agree with Ofgem's assessment that the benefits of appointing an independent third party to assess Unidentified Gas would accrue to the industry?***

SGD agrees with Ofgem's view that 0229 would have significant benefits over the alternative proposals. To the extent that there are competing commercial and market sector interests, the appointment of an independent 3<sup>rd</sup> party would mean that any allocation of costs could be undertaken on an impartial basis. In the absence of meter point reconciliation for the entire SSP sector, this is the next best solution.

One aspect of the appointment of a 3<sup>rd</sup> party expert under 0229 that has not been mentioned is the extent to which its work could be used by Ofgem for future Price Control and other revenue-setting work. This could prove very useful in challenging submissions from GTs.

## **CHAPTER: Nine**

***Question 1: Do you believe that a post-implementation review will be necessary for the Modification Proposals which Ofgem is minded to implement?***

Given the impartial nature of the work of the expert in 0229 and the proposal's provisions for challenges to methodology and process, along with the tendering procedure, it is not immediately clear that a review would be required.

However, SGD agrees that the arbitrary nature of 0228 or 0228A would necessitate a review.

I hope you have found these comments useful. Please do not hesitate to contact me should you have any queries.

Yours sincerely



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